

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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In the Matter of the Application of CALIFORNIA WATER SERVICE COMPANY (U-60-W), a California corporation, for an order (1) authorizing it to increase rates for water service by \$94,838,100 or 16.5% in test year 2017, (2) authorizing it to increase rates by \$22,959,600 or 3.4% on January 1, 2018, and \$22,588,200 or 3.3% on January 1, 2019, in accordance with the Rate Case Plan, and (3) adopting other related rulings and relief necessary to implement the Commission's ratemaking policies.

Application 15-07-015
(Filed July 9, 2015)

**REPLY BRIEF OF
CALIFORNIA WATER SERVICE COMPANY**

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SUBJECT INDEX

	<u>Page(s)</u>
I. THE COMMISSION SHOULD ALLOW CAL WATER TO RECOVER A PORTION OF THE RECORDED COSTS ASSOCIATED WITH THE SOUTH BAKERSFIELD WATER TREATMENT PLANT	1
A. The City Mischaracterizes Cal Water’s Request for Recovery Related to the South Bakersfield WTP.	1
B. Cost Recovery In Connection with the South Bakersfield WTP Does Not Violate the Retroactive Ratemaking Doctrine.	1
C. The Commission May Authorize Recovery of Costs Associated with a Cancelled Project	1
II. THE COMMISSION SHOULD REJECT ORA’S ESCALATION YEAR-RELATED RECOMMENDATIONS	1
A. Escalation Year Advice Letter Filings	1
B. Pro Forma Earnings Test.....	1
III. CONCLUSION	1

TABLE OF AUTHORITIES

Page(s)

CALIFORNIA PUBLIC UTILITIES COMMISSION DECISIONS

D.07-05-062, <i>Order Instituting Rulemaking to Consider Revisions to the General Rate Case Plan for Class A Water Companies</i> , 2007 Cal. PUC LEXIS 226	4
D.04-06-018, <i>Order Instituting Rulemaking to Evaluate Existing Practices and Policies for Processing General Rate Cases</i> , 2004 Cal. PUC LEXIS 276.....	4
D.10-12-017, <i>Application of California Water Service Company (U60W) for an order 1) authorizing it to increase rates for water service by \$70,592,000 or 16.75% in test year 2011, 2) authorizing it to increase rates on January 1, 2012 by \$ 24,777,000 or 5.04% and January 1, 2013 by \$ 24,777,000 or 4.79%</i> , 2010 Cal. PUC LEXIS 472	5
D.14-01-017, <i>Application of California Water Service Company (U60W) for Authority to Recover Costs Associated with General Office Building Renovation</i> , 2014 Cal. PUC LEXIS 12	5, 6
D.06-11-050, <i>Application of California-American Water Company (U 210 W) an order authorizing it to increase its rates for water service in its Monterey District to increase revenues by \$ 9,456,100 or 32.88% in the year 2006; \$ 1,894,100 or 4.95% in the year 2007; and \$ 1,574,600 or 3.92% in the year 2008</i> , 2006 Cal. PUC LEXIS 479	6

OTHER AUTHORITY

Rules of Practice and Procedure	
Rule 13.11	1

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(Filed July 9, 2015)

**REPLY BRIEF OF
CALIFORNIA WATER SERVICE COMPANY**

In accordance with Rule 13.11 of the Rules of Practice and Procedure ("Rules") of the California Public Utilities Commission ("Commission"), California Water Service Company ("Cal Water" or "the company") hereby submits its reply brief, responding to the arguments made by the City of Bakersfield (occasionally referred to herein as the "City") and the Office of Ratepayer Advocates ("ORA") in their respective opening briefs in connection with the two contested issues in this general rate case ("GRC").

Administrative Law Judge ("ALJ") Dan Burchum set the deadline for submitting reply briefs during the telephonic Status Conference held on August 17, 2016. Due to a mistake on the part of Cal Water regarding this deadline, Cal Water's reply brief was not timely filed in accordance with said schedule. By the concurrently filed Motion to Accept Late-Filed Documents, Cal Water respectfully requests leave to submit this reply brief for filing at this time.

I. THE COMMISSION SHOULD AUTHORIZE CAL WATER TO RECOVER A PORTION OF RECORDED COSTS ASSOCIATED WITH THE SOUTH BAKERSFIELD WATER TREATMENT PLANT.

The City of Bakersfield urges the Commission to deny Cal Water recovery of any costs associated with the initial planning, permitting and design phase of the South Bakersfield WTP. The City claims that that Cal Water “imprudently” incurred costs to pursue a project that the City now describes as “not necessary, practical or feasible.”¹ The City also argues that Cal Water’s supposed failure to secure Commission approval to explore the feasibility of the project in advance means that Cal Water forfeits any claim to recovery of costs associated with that preliminary investigation. The City’s arguments are without merit.

A. The City Mischaracterizes Cal Water’s Request for Recovery Related to the South Bakersfield WTP.

As a preliminary matter, Cal Water finds it necessary to correct the City of Bakersfield’s repeated claims that Cal Water “seeks to recover all of the costs and expenses it incurred” or a total of “approximately \$4.6 million in costs” related to the South Bakersfield WTP.² Cal Water has never requested the Commission authorize recovery of the total amount of costs reasonably expended by Cal Water to pursue this important water supply project in collaboration with the City. As detailed in Cal Water’s opening brief, Cal Water’s Application requested the company be allowed to amortize \$3.3 million (of the \$4,676,312.46) in costs associated with the South Bakersfield WTP over a 10-year period.³ In settlement with ORA, Cal Water agreed to reduce that request to approximately \$1.6 million – a reduction on the order of fifty percent of the amount proposed to be amortized in the Application, and nearly sixty-six

¹ City of Bakersfield Opening Brief, at 2.

² City of Bakersfield, at 4, 6, and 7.

³ Cal Water Opening Brief, at 9.

percent of the costs actually incurred. As Cal Water made very clear in its opening brief, it is this latter proposal that ORA has agreed to as part of a comprehensive settlement for which Cal Water seeks Commission approval.⁴

B. Cost Recovery in Connection with the South Bakersfield WTP Does Not Violate the Retroactive Ratemaking Doctrine.

The City of Bakersfield argues that to approve the resolution of this issue provided in Cal Water's settlement with ORA would violate the retroactive ratemaking doctrine.⁵ The City asserts that "the Commission must reject CWS's request to recover the unauthorized and unapproved" costs associated with the South Bakersfield WTP, because Cal Water "never sought Commission review and approval" for the project.⁶ The City claims that Cal Water's alleged failure to comply with the "required regulatory procedures for the recovery of prior costs and expenses" bars recovery in this proceeding.

The City of Bakersfield is wrong. First, Commission-regulated utilities are not required to request advance authorization from the Commission in order to pursue capital projects. While a utility provides detail on specific projects in its GRC to justify its requested budget, it retains the discretion to implement any projects necessary to provide service to customers, even if they were not previously presented to the Commission. That capital projects are routinely constructed without pre-approval by the Commission is evidenced by the fact that the Revised Rate Case Plan for Class A Water Utilities (the "Rate Case Plan") specifically requires a GRC applicant to "[l]ist plant improvements built in the last test years but not

⁴ Cal Water Opening Brief, at 10.

⁵ City of Bakersfield Opening Brief, at 5-6.

⁶ City of Bakersfield Opening Brief, at 6.

authorized.”⁷ Moreover, the third year of a water utility’s capital budget uses an attrition year methodology, which provides for rate increases based on an adopted formula rather than precise projections.⁸ Use of an attribution year builds in the flexibility that may be necessary for a utility to appropriately address its capital needs in real time – without going back to the Commission before a new GRC application is filed.

Second, Cal Water did, in fact, comply with regulatory procedures established specifically to address the then-proposed South Bakersfield WTP and has been careful to inform the Commission about this project as it progressed.⁹ As Cal Water witness Duncan explained during evidentiary hearings, the South Bakersfield WTP was originally proposed in Cal Water’s 2009 GRC, Application (“A.”) 09-07-001. As part of that application, Cal Water provided project justifications and requested project financing for the South Bakersfield WTP.¹⁰ Cal Water also explained the fact that the ORA team visited the proposed site of the water treatment plant during the ORA fact finding tour.¹¹ Cal Water was also forthcoming with ORA in discussing Cal Water’s plans for the design/build concept for an alternative project delivery method, and at the time of settlement discussions in the 2009 GRC, the project was still moving forward.¹² In resolving Cal Water’s 2009 GRC, the Commission approved a settlement agreement between Cal Water and the Division of Ratepayer Advocates¹³ that authorized Cal

⁷ D.07-05-062, 2007 Cal. PUC LEXIS 226, at * 90 (Minimum Data Requirements relevant to Rate Base).

⁸ D.07-05-062, Appendix A, at A-19; D.04-06-018, at 5.

⁹ Reporter’s Transcript (“RT”) 473:20 – 28 (Duncan/CWS).

¹⁰ RT 473:28 – 474:4 (Duncan/CWS).

¹¹ RT 473:24 – 473:28 (Duncan/CWS).

¹² *Id.*

¹³ The Division of Ratepayer Advocates is ORA’s predecessor and will be referred to herein as “ORA” for ease of reference.

Water to file a separate application for recovery of costs for the South Bakersfield WTP.¹⁴ The decision, D.10-12-017, indicates that Cal Water requested and was authorized to accrue Allowance for Funds Used During Construction (“AFUDC”) for the South Bakersfield WTP, and to accrue Interest During Construction (“IDC”) consistent with applicable financial accounting standards.¹⁵ D.10-12-017 further states that “this method” shall be applied to the South Bakersfield WTP, as well as certain other of Cal Water’s major capital projects, including its General Office building expansion.¹⁶

The General Office building expansion provides a helpful example of the Commission process for capital projects. Cal Water first raised the issue of its planned building renovation in its 2007 GRC.¹⁷ Cal Water discussed the project again in its 2009 GRC, at which time the Commission adopted the aforementioned settlement provision allowing Cal Water to pursue recovery of the renovation costs in a separate application.¹⁸ In 2012, after completion of the work, Cal Water requested recovery of the costs associated with its General Office building expansion by that separate application, and was authorized to recover over 95% of those costs through a customer surcharge.¹⁹ The Commission’s D.14-01-017 expressly noted that “Cal Water is correct in its assertion that the Commission specifically authorized Cal Water to seek recovery” of its building renovation costs.²⁰ Therefore, the Commission concluded, “this Commission invited Cal Water to avail itself of the application process as the appropriate

¹⁴ RT 473:20 – 474:18 (Duncan/CWS).

¹⁵ D.10-12-017, at 38, 67 (Finding of Fact No. 50), and 89 (Ordering Paragraph No. 28).

¹⁶ D.10-12-017, at 89 (Ordering Paragraph No. 28).

¹⁷ D.14-01-017, at 2.

¹⁸ D.14-01-017, at 2; D.10-12-017, Attachment C (Further Amended Settlement) at C-470 and C-471.

¹⁹ D.14-01-017, at 16-17 (Ordering Paragraph Nos. 1-4).

²⁰ D.14-01-017, at 5, 9, and 16-17 (Ordering Paragraph No. 2).

procedural vehicle to seek approval” of the project referred to in settlement.²¹ The only material difference between Cal Water’s General Office building renovation and its South Bakersfield WTP in terms of following “appropriate” procedures is that, once the City suddenly and unexpectedly dropped out of the project, Cal Water never had the opportunity to complete the South Bakersfield WTP in order to file a separate application to recover its costs. This difference does not, however, denote retroactive ratemaking.

C. The Commission May Authorize Recovery of Costs Related to a Cancelled Project.

The City itself recognizes that there are circumstances under which the Commission has authorized the recovery of costs associated with a project that is ultimately cancelled.²² The Commission has held that, in periods of great uncertainty for utility planners, it can be appropriate for ratepayers to bear some of the costs incurred for a project that is ultimately cancelled, “if the Utility demonstrates that it has exercised reasonable managerial skill in (1) identifying, assessing, and to the extent possible, quantifying the risks relevant to its ability and obligation to maintain adequate and reasonable service (“identifying relevant risks”), (2) analyzing projects such that the choice of project reflects an overall strategy to minimize costs, consistent with quality and dependability of service (“analyzing particular projects”), and (3) frequently reviewing its project commitments and overall supply strategy (“reevaluations”).”²³ Contrary to the City’s claim that Cal Water “has not made that showing, or attempted to make that showing, in this proceeding,”²⁴ the record shows that Cal Water has

²¹ D.14-01-017, at 9.

²² City of Bakersfield Opening Brief, at 7 (FN 26).

²³ D.06-11-050, at 51.

²⁴ City of Bakersfield Opening Brief, at 7 (FN 26).

established the basis upon which the Commission should find it appropriate for Cal Water's ratepayers to share in the costs of a cancelled project.

1. Uncertainty

With respect to the requisite circumstances of great uncertainty for utility planners, Cal Water has described how uncertain the reliability of the Bakersfield District's water supply has been in recent years due to extended drought conditions, water quality issues and declining groundwater elevations.²⁵ Cal Water has been actively pursuing projects to obtain additional water supply in Bakersfield amid these worsening regional conditions and the decision to pursue the South Bakersfield WTP was made in this context.²⁶

2. Reasonable Managerial Skill

As noted above, the Commission determines "reasonable managerial skill" by determining whether the utility: (1) identified relevant risks, (2) analyzed the particular project and (3) reevaluated the project over time. Cal Water exercised reasonable managerial skill in pursuing the South Bakersfield WTP. Under the facts and circumstances that existed at the time, Cal Water considered a partnership with the City to construct the South Bakersfield WTP project to be a valuable opportunity in many respects.

a. Identifying Relevant Risks

Cal Water had already successfully partnered with the City to deliver the Northeast WTP and the Northwest WTP and had good reason to believe that the company would be similarly successful in developing the South Bakersfield WTP project.²⁷ Cal Water witness Duncan testified that "[t]he City of Bakersfield had been telling us all along that they supported

²⁵ Exh. CWS-14, at 13-14; RT 476:3 – 11 (Duncan/CWS); Cal Water Opening Brief, at 10.

²⁶ Exh. CWS-111, Rebuttal Testimony on Capital Projects (Book 3), at 187 (Duncan).

²⁷ RT 480:25 – 481:17 (Duncan/CWS).

the project, that they wanted to pursue it.”²⁸ In addition to receiving “a lot of day-to-day staff comments telling us this was a good project to pursue, and they partnered with us on it,” Cal Water received a letter from the City stating the City’s intent to pursue the project.”²⁹ In this letter, the City referred to the South Bakersfield WTP as a “mutually beneficial project” and indicated that the City was “in the process of finalizing agreements necessary for this important project to move forward.”³⁰

In light of the apparent strength of this collaboration, Cal Water believed not pursuing the project was the greater risk to its ability to maintain adequate supply and service in its Bakersfield District. In terms of properly identifying relevant risks, Cal Water considered its relationship with the City to be a factor weighing in favor of pursuing the project, based on its long history of successful partnerships and the potential for the South Bakersfield WTP to benefit both systems, rather than the risk to project delivery it turned out to be.

b. Analyzing Particular Projects

Regarding Cal Water’s analysis of particular projects, the decision to try to develop the South Bakersfield WTP reflected an overall strategy to minimize costs without compromising quality and dependability of service. Cal Water recognized that partnering with the City had significant potential benefits from a cost efficiency standpoint.³¹ As Cal Water witness Duncan explained during evidentiary hearings, “[Cal Water] expected [the City] to pay half” in a 50/50 cost-sharing arrangement, much like with the Northwest WTP.³² This arrangement would have minimized costs to Cal Water’s ratepayers to develop valuable supply

²⁸ RT 478:20–24 (Duncan/CWS).

²⁹ RT 478:22–24 (Duncan/CWS).

³⁰ Exh. CWS-116; RT 487:4–22 (Duncan/CWS).

³¹ RT 481:5–10, 482:24 – 483:7 (Duncan/CWS); Cal Water Opening Brief, at 11-12.

³² RT 488:27–28 (Duncan/CWS).

and was a specific consideration in analyzing this particular project. Only once the City decided to back out of the South Bakersfield WTP did it become “not feasible for Cal Water cost-wise” to pursue it further.³³

c. Reevaluation

Finally, the Commission has required that utility management regularly reevaluate its project commitment and overall supply strategy to demonstrate the exercise of reasonable managerial skill. As indicated in Cal Water’s testimony, Cal Water worked closely with City staff to analyze the feasibility of the South Bakersfield WTP and to develop an accurate project scope, cost and schedule for the project.³⁴ Cal Water diligently pursued project development during the 2007-2011 period and evaluated and reevaluated the project’s utility and feasibility as issues arose that eventually changed the project calculus and led to its cancellation.³⁵ Cal Water’s efforts to evaluate project viability continued even after the City notified Cal Water that it would no longer participate in the project,³⁶ as Cal Water worked to ascertain if the project could benefit its Bakersfield District enough to justify moving forward with it even without the City’s involvement.³⁷ Unfortunately, Cal Water determined that, at that time, the investment simply did not work for Cal Water and its ratepayers without the City’s participation.³⁸

The City of Bakersfield and Cal Water disagree on the appropriate treatment of costs incurred in connection with the preliminary development of the South Bakersfield WTP for ratemaking purposes. However, no principle of law or Commission policy bars the Commission

³³ RT 478:9–16 (Duncan/CWS); Cal Water Opening Brief, at 12.

³⁴ RT 475:5–15 (Duncan/CWS).

³⁵ Cal Water Opening Brief, at 12-13.

³⁶ Cal Water did not charge any costs to the project after the time it was informed by the City that the City would not participate in the South Bakersfield WTP. RT 483:20–25 (Duncan/CWS).

³⁷ RT 479:2–8 (Duncan/CWS); Cal Water Opening Brief, at 13-14.

³⁸ Cal Water Opening Brief, at 12-13.

from authorizing Cal Water to recover costs associated with the project, and Cal Water respectfully requests the Commission approve the negotiated proposal set forth in the Settlement Agreement between Cal Water and ORA, authorizing Cal Water to amortize \$1.6 million of such costs over a 10-year period, with the unamortized balance earning Cal Water's cost of debt.

II. THE COMMISSION SHOULD REJECT ORA'S ESCALATION YEAR-RELATED RECOMMENDATIONS.

In its opening brief, ORA urges the Commission to adopt an ordering paragraph that would require Cal Water to file escalation year advice letters to revise revenue requirements and corresponding tariff schedules in each of its 23 districts, regardless of whether Cal Water is over- or under-earning.³⁹ ORA also recommends the Commission reject Cal Water's proposal to exclude the pro forma earnings test in favor of adopting fixed amounts in escalation year filings.

A. Escalation Year Advice Letters

As Cal Water explained in its opening brief, even though it creates an unnecessary administrative burden for Cal Water and the Commission, if clarifying language is added to ORA's recommended ordering paragraph, Cal Water would not oppose its adoption. Alternatively, Cal Water would commit to making escalation year filings in each of its 23 districts, provided that: (1) filings are by Tier 1, rather than Tier 2, advice letter as Cal Water has always done;⁴⁰ and (2) ORA's recommended language is not interpreted to require Cal Water to make downward adjustments in revenue requirements (thereby reducing rates) where the earnings test indicates that the company is "over-earning" in a district. ORA's opening brief

³⁹ Note that this is the same language ORA proposed to be adopted in its Report on Results of Operations, except that the reference to the Commission's Division of Water and Audits is replaced by a reference to the Water Division, presumably in recognition of the recent reorganization of these Commission divisions.

⁴⁰ See Cal Water Opening Brief, at 6.

cites extensively to D.15-04-007 as an example of the Commission having already adopted this interpretation. However, as Cal Water explained in its opening brief, D.15-04-007 does not, in fact, order the water utility in that case to, in effect, “true up” its rates, as ORA asserts.⁴¹

Furthermore, ORA’s opening brief seems to suggest that if the Commission declines to adopt its proposal, ratepayers would be deprived of something to which they are entitled.⁴² But ORA fails to acknowledge that water utility escalation year increases are already capped by the amount adopted in the utility’s GRC decision, regardless of how dramatic the under-earnings may be. To adopt ORA’s proposal to use escalation year filings to require Cal Water to make downward adjustments in rates would only exacerbate a one-sidedness in escalation year ratemaking. This one-sided policy already has consequences, including making the first year request in the next mandated filing larger, to the detriment of ratepayers.⁴³

B. Pro forma Earnings Test

ORA requests that the Commission require that Cal Water’s escalation year filings include the pro forma earnings test “in order to determine the reasonableness of the requested rate increases or decreases for each district.”⁴⁴ Contrary to ORA’s claim that “there is no justification for excluding the pro forma earnings test” from escalation year filings, as Cal Water has explained in its opening brief, excluding the pro forma earnings test for water utilities would better balance ratepayer and stockholder interests and is consistent with the Commission’s policy for energy utility post-test year attrition rate adjustment mechanisms.⁴⁵

⁴¹ Cal Water Opening Brief, at 7.

⁴² ORA Opening Brief, at 4.

⁴³ See Cal Water Opening Brief, at 6-7.

⁴⁴ ORA Opening Brief, at 8.

⁴⁵ Cal Water Opening Brief, at 7-8.

ORA recommends that the earnings test results be used to determine if a rate reduction or a greater rate reduction than adopted is warranted. However, ORA is not recommending that the earnings test results be used to determine if a rate increase greater than what was adopted is warranted, making its proposal unfairly one-sided. While considerable time can be spent discussing the mechanics of the earnings test, which was put into place before the water utilities were required to file rate increases pursuant to the Rate Case Plan, suffice it to say that it is not a true test of earnings. The pro forma earnings test uses adopted expenses as opposed to recorded expenses. As a result, it does not represent a water utility's actual earnings. Because of this, the earnings test is nothing more than a comparison of recorded versus adopted capital expenditures. Furthermore, ORA has provided no justification why energy utilities and water utilities, which have the same basic ratemaking procedures and policies, should be treated differently for escalation year increases.

In the event the Commission adopts ORA's recommended escalation year ordering paragraph, despite the negative implications of doing so, Cal Water requests that its clarifying language be added, as follows:

For escalation years 2018 and 2019, CWS shall file Tier 2 advice letters in conformance with General Order 96-B proposing new revenue requirements and corresponding revised tariff schedules for each ratemaking area. The filing shall include rate procedures set forth in the Commission's Rate Case Plan (Decision 07-05-062), **excluding the pro forma earnings test**, for Class A Water Utilities and shall include appropriate supporting workpapers. The revised tariff schedules shall take effect no earlier than January 1, 2018 and January 1, 2019, respectively and shall apply to service rendered on and after their effective dates. The proposed revisions to revenue requirements and rates shall be reviewed by the Commission's Water Division. The Water Division shall inform the Commission if it finds that the revised rates do not conform to the Rate Case Plan, this order, or other Commission decisions, and if so, reject the filing.

III. CONCLUSION

For all the reasons set forth above and in its opening brief, California Water Service Company respectfully asks that the Commission: (1) authorize Cal Water to recover a portion of the costs incurred for preliminary development of the South Bakersfield WTP, as presented in the Settlement Agreement; and (2) reject ORA's recommendations to require Cal Water to file escalation year adjustments by Tier 2 advice letter and to make downward adjustments to revenue requirements where the earnings test indicates a district is over-earning.

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